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QUESTIONS PRESENTED

1. Where the parties did not clearly and unmistakably agree that the question of arbitral jurisdiction was for the arbitrators and not for the courts, did the court of appeals properly review *de novo* the arbitrators' assertion of jurisdiction over the controversy?

2. Did the court of appeals properly apply ordinary appellate review to the district court's refusal to vacate the arbitration award, rather than altering the standard of appellate review based on the outcome of the district court proceedings?

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

No. 94-560

FIRST OPTIONS OF CHICAGO, INC.,
Petitioner,

v.

MANUEL KAPLAN, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF FOR RESPONDENT MANUEL KAPLAN

STATEMENT OF THE CASE

From 1984 until January 1989, respondent M.K. Investments, Inc. ("MKI") was an options market maker on the Philadelphia Stock Exchange ("the Exchange"). Petitioner First Options of Chicago, Inc. ("First Options") is the largest clearinghouse at the Exchange and functioned as MKI's clearinghouse until January 1989, when First Options took over MKI's trading account and put MKI out of business.[1] At the time of the arbitration underlying this case, Mr. Kaplan and MKI had been out

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[1] An options market maker trades options for its own account. A clearinghouse facilitates a market maker's trading by providing administrative support and risk control services and by guaranteeing a market maker's account to other traders. A clearinghouse is compensated by, *inter alia*, commissions generated by the market maker.

of business and off the Exchange for three years. Pet. App. A4, A9; Joint Appendix ("J.A.") 65.

Respondent Manuel Kaplan was the president and, from 1986 on, the sole shareholder of MKI. Respondent Carol Kaplan is Manuel Kaplan's wife. She has never had any ownership interest in MKI, nor did she have any dealings or affiliation with First Options or the Exchange. Pet. App. A5; J.A. 65. MKI itself is only a nominal respondent here. The court of appeals affirmed the district court's judgment with respect to MKI, and MKI did not seek further review. Accordingly, as the case comes to this Court, it concerns only Petitioner's efforts to arbitrate its claims against Mr. and Mrs. Kaplan. As explained in further detail below, Petitioner has persisted in this effort despite the fact that neither Mr. Kaplan nor Mrs. Kaplan ever entered into any agreement to arbitrate with First Options.

In an apparent effort to skew the Court's view of the legal issues presented here, Petitioner sets forth a distorted version of the facts. Many of Petitioner's assertions are not supported by the record and are in any event irrelevant to the questions on which the Court has granted review. In the paragraphs that follow, we do not attempt to address all of the unfounded accusations in Petitioner's brief, but instead focus on the facts relevant to the issues before the Court.

A. The Crash, the Workout, and the Release

In October, 1987, as a result of the largest percentage drop in stock exchange history ("the Crash"), MKI's trading account lost a $10 million positive balance almost overnight. The net equity in the MKI trading account went from $10.5 million on October 14, 1987 to *negative* $2.1 million on October 19, 1987. Pet. App. A5.

After the Crash, First Options took control of the MKI account and liquidated all of MKI's positions. In the course of that liquidation, First Options *decreased* the

value of the MKI account to negative $5.1 million. Pet. App. A5-A6.

MKI and First Options almost immediately entered into settlement negotiations concerning MKI's negative balance. Under the 1984 Market-Maker Agreement that governed MKI's relationship with First Options, *see* Pet. App. A4-A5, MKI was liable to First Options for any deficit balance in its accounts, but MKI's principals did not assume any personal liability. First Options nevertheless sought to hold Mr. Kaplan personally liable for the entire $5.1 million. Mr. Kaplan and MKI contested the amount of the debt, contending that First Options had increased the debt by mishandling the account in liquidation. Pet. App. A6.

In late 1987, the parties reached a "handshake deal," agreeing on the general terms of a workout. Pet. App. A6. Over the next four months, the parties negotiated the details of a four-contract, 28-page settlement/workout agreement, spelling out all the rights and liabilities of the parties. Pet. App. A6-A8; J.A. 4-38.[2] First Options was represented in the workout negotiations primarily by its Philadelphia branch manager and several in-house attorneys for Continental Illinois Bank, First Options' parent at the time. R. 710.[3] MKI was represented by Mr. Kaplan, and by its and his attorney, Steve Wallenstein. R. 815.[4]

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[2] That settlement completely resolved all prior differences among the parties, rendering any pre-workout disputes irrelevant. Pet. App. A6; J.A. 19-20.

[3] "R." refers to the four-volume appendix to respondents' brief in the court of appeals.

[4] Petitioner misrepresents the circumstances surrounding Mr. Kaplan's withdrawal of funds following the Crash (a withdrawal unrelated to the issues before this Court). Petitioner claims that "[i]nstead of using this cash to repay MKI's creditors, Mr. Kaplan withdrew $611,300 between October 19 and December 18, 1987." Pet. Br. at 3. In a proceeding brought by First Options to deter-

Because certain aspects of the workout were applicable only to certain parties, the agreement consisted of four separate contracts, each signed by different parties. Only one of the four contracts (the Subordinated Loan Agreement) contained an arbitration clause, and that contract was signed only by First Options and MKI—*not* by Manuel or Carol Kaplan. J.A. 30-36, 57; Pet. App. A6-A7. Manuel and Carol Kaplan signed only one of the four contracts (the Letter Agreement), and that contract *did not contain an arbitration provision.* J.A. 4-23, 57; Pet. App. A7.[5]

The salient points of the settlement, signed March 24, 1988, were as follows:

- The corporation MKI agreed to repay the full amount of the Crash debt, including the $3 million created by First Options' trading of the account. J.A. 4.

---

mine the dischargeability of Mr. Kaplan's judgment debt, however, the United States Bankruptcy Court for the Eastern District of Pennsylvania found, on the basis of uncontroverted testimony, that the withdrawn funds *were* used to repay MKI's creditors. *In re Kaplan*, 162 B.R. 684, 702 (Bankr. E.D. Pa. 1993).

[5] Contrary to Petitioner's contention, Pet. Br. at 3, the arbitration clause in the Subordinated Loan Agreement did not "on its face appl[y] to the Letter Agreement." It merely provided that the parties to the Subordinated Loan Agreement—*i.e.*, First Options and MKI—would arbitrate any disputes arising out of the Letter Agreement. J.A. 34-35.

Moreover, Paragraph 12 of the Letter Agreement specifically provided that the signature of Mrs. Kaplan—who received no consideration under the workout—had only the limited effect of evidencing her agreement to cooperate in remitting the joint tax refund: "Mrs. Kaplan is signing this agreement to evidence her agreement to sign all documents necessary to fulfill the terms of this agreement applicable to her," *i.e.*, remittance of the 1987 joint tax refund. J.A. 20. Mrs. Kaplan did not "agree[] on the terms of a workout," Pet. Br. at 3. She agreed only to remit a refund check.

- MKI immediately transferred more than $500,000 in Exchange memberships to First Options. J.A. 6.
- MKI and Mr. Kaplan immediately contributed $900,000 to fund a new trading account—

  $400,000 from MKI's interest in a specialist account; and

  $500,000 from Mr. Kaplan's personal funds. J.A. 7-8; R. 1234.
- Mr. Kaplan immediately paid First Options $80,000. J.A. 6; R. 1234, 1383.
- Mr. Kaplan (and Mrs. Kaplan) agreed to remit to First Options their 1987 joint tax refund, estimated to be $300,000, upon receipt. J.A. 7.
- MKI agreed to split its future trading profits with First Options. J.A. 10-13.

First Options also agreed to release the corporation (MKI) and Mr. Kaplan (individually). However, because the debt belonged to the corporation and not to Mr. Kaplan, the releases differed in one critical respect:

- First Options released MKI from any claims First Options might have against MKI for the disputed debt, *upon performance of MKI's obligations under the Agreement (i.e., payment in full of the debt).* J.A. 19.
- First Options *unconditionally* released Mr. Kaplan from any claims First Options might have against him personally for the disputed debt. J.A. 20.

Mr. Kaplan did not personally guarantee MKI's debt under the workout. J.A. 4-5, 30.

B. The Dispute

Pursuant to the workout agreement, MKI resumed trading in April, 1988. On January 17, 1989, Barry Seidman (First Options' CEO) and Mr. Kaplan engaged in a "heated exchange" on a conference call, R. 726,

and Mr. Seidman ordered Mr. Kaplan to leave the office. R. 687-88, 875.[6] First Options thereafter ordered all MKI traders off the trading floor, shut off MKI's phones, changed the locks on MKI's office, and barred Mr. Kaplan from MKI's premises. R. 876. Neither Mr. Kaplan nor MKI has been able to trade options since. R. 1114, 1323.

Soon after ousting Mr. Kaplan from his business, First Options demanded: (i) that Mr. and Mrs. Kaplan turn over their 1987 joint tax refund and (ii) that MKI open its books and records for inspection. R. 249-52. Because they believed (and still believe) that First Options had destroyed MKI's business without justification, the Kaplans did not comply. First Options declared an event of acceleration under the workout and demanded immediate repayment *by MKI* of the full workout debt. R. 252.

On June 21, 1989, First Options filed for arbitration, seeking an award against Manuel and Carol Kaplan for the amount of the 1987 joint tax refund, and contending, based on a piercing-the-corporate-veil theory, that Manuel Kaplan—as well as MKI—was liable for the full workout debt of the corporation. R. 62-71; J.A. 54.

C. The Arbitration

MKI and First Options (but not Manuel or Carol Kaplan) signed a Submission Agreement presenting their dispute to the Exchange for arbitration. J.A. 54. By contrast, Manuel and Carol Kaplan "refused to sign any submission form," Pet. App. A18, and formally objected to Exchange jurisdiction. J.A. 54-55; R. 172, 175.

On February 26, 1990, the Exchange conducted a pre-hearing discovery conference. The parties stipulated as follows regarding the events at that conference:

[6] The substance of that phone call and the reasons for First Options' banishment of Mr. Kaplan remain vigorously disputed by the parties, but are irrelevant to the issues before this Court.

> 5. The Kaplans' then-counsel Thomas Zielinski withdrew the Kaplans' jurisdiction objections *from consideration at the February 26, 1990 discovery conference*. The Kaplans thereafter participated without objection in the pre-hearing conference on February 26, 1990.
>
> 6. The February 26, 1990 discovery order made no mention of the jurisdictional issue.

J.A. 55 (emphasis added). The Kaplans' former counsel set aside the Kaplans' jurisdictional objections from consideration at the discovery conference only in order to participate in that conference. This temporary and limited withdrawal did not waive the objections. As the court of appeals held:

> The Kaplans did not waive their objections. They reasserted them regularly during the arbitration proceeding. Repeated objection was not required while the case lay dormant. Their participation in the 1990 discovery conference did not waive their objections to the arbitrators' jurisdiction. We cannot say that this act "clearly indicated [their] willingness to forego judicial review."

Pet. App. A21 (quoting *Pennsylvania Power Co. v. Local Union No. 272*, 886 F.2d 46, 50 (3d Cir. 1989)).[7]

Following the February 26, 1990 discovery conference, the case lay dormant for 22 months—no discovery took place, no motions were filed, and no rulings were issued. Pet. App. A11; J.A. 55. In December, 1991, new counsel took over the case for the Kaplans. J.A. 55. On January 6, 1992, Mr. and Mrs. Kaplan filed a motion to dismiss for lack of jurisdiction. In their supporting memorandum, the Kaplans stated that they were "reiterat[ing] and re-

[7] The February 26, 1990 discovery order was subsequently vacated. J.A. 58. Thus, the February 26, 1990 discovery conference—the basis on which First Options alleged that the Kaplans had waived their jurisdictional objections—had no substantive impact on the arbitration proceeding.

new[ing] their objections to the [Arbitration] Committee's jurisdiction." On January 14, 1992, the Exchange denied the motion to dismiss without explanation. J.A. 39, 55.[8]

On June 5, 1992, the Exchange Arbitration Panel issued its decision in favor of First Options and against the Kaplans. By a vote of 5 to 2, the Panel:

- entered an award against MKI in the amount of $5,662,188, plus interest;
- held Manuel Kaplan jointly and severally liable for the MKI debt (piercing the MKI corporate veil);
- entered an award against Manuel Kaplan in the amount of the 1987 joint tax refund ($346,342), plus interest;
- held Carol Kaplan jointly and severally liable for the 1987 joint tax refund, plus interest; and
- denied Manuel Kaplan's and MKI's counterclaims based on First Options' destruction of the MKI business in January, 1989. J.A. 40-43, 64.

Respondents filed a timely petition to vacate the arbitral award, and Petitioner filed a cross-petition to confirm the award. In the district court, the parties stipulated to virtually all the relevant facts. *See* J.A. 54-67; Pet. App. C1-C2.

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[8] The Order on the motion to dismiss makes no mention of any waiver and gives no indication that it was decided other than on the merits. J.A. 39. Indeed, the Order states that the motion was denied "after full consideration." *Id.* Moreover, in a telephone conversation after the Exchange's ruling, the Director of Arbitration informed the Kaplans' counsel that the ruling was consistent with the Exchange's standing interpretation of arbitral jurisdiction. She did not mention any withdrawal or waiver of the Kaplans' jurisdictional objections. J.A. 52.

D. The District Court Ruling

In an unpublished memorandum and order entered September 25, 1992, the district court confirmed the arbitration award. Pet. App. C1-C35. The court held that Manuel and Carol Kaplan had consented to Exchange arbitration through the arbitration provision in the Subordinated Loan Agreement, even though neither Manuel nor Carol Kaplan had signed that Agreement. *Id.* at C10-C14. Alternatively, the court held that the Kaplans, by their former counsel, had waived their jurisdictional objections. Id. at C14.[9]

Respondents appealed the district court's decision. On February 2, 1993, Mr. Kaplan filed a petition for relief under the Bankruptcy Code (Bankr. E.D. Pa. No. 93-10625S). On March 10, 1993, the bankruptcy court modified the automatic stay to permit Mr. Kaplan's appeal to proceed.

E. The Court of Appeals Ruling

On March 31, 1994, the Court of Appeals for the Third Circuit affirmed the district court's judgment as to MKI,[10] but reversed as to Manuel and Carol Kaplan, holding that the arbitrators lacked jurisdiction over the Kaplans. Pet. App. A3-A4.

In its unanimous opinion, the court of appeals held:

- that it would review *de novo* the district court's denial of Respondents' petition to vacate the arbitration award, Pet. App. A13;

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[9] The court also affirmed the Exchange's decision to pierce the corporate veil, holding that Mr. Kaplan's release was conditional upon performance of the workout agreement, and therefore void because Mr. Kaplan had not fully performed. Pet. App. C30. Without explanation, the court held, in the alternative, that the veil was properly pierced even if Mr. Kaplan's release was unconditional. *Id.*

[10] MKI did not file a cross-petition for certiorari in this Court; therefore, the judgment against MKI is not at issue here.

- that the Kaplans had not waived their jurisdictional objections, Pet. App. A17-A21;
- that because arbitrability is a question for the court to decide, the arbitrators' assertion of jurisdiction over the Kaplans was not entitled to deference, Pet. App. A22-A23;
- that the arbitrators lacked jurisdiction over the Kaplans, Pet. App. A3-A4; [11] and
- that the evidence was insufficient to allow the piercing of MKI's corporate veil to impose $5,662,188 in personal liability upon Mr. Kaplan, Pet. App. A52.[12]

On June 29, 1994, the court of appeals denied First Options' Petition for Rehearing with Suggestion for Rehearing In Banc. Pet. App. B1-B2. First Options filed a petition for certiorari, which this Court granted on December 5, 1994. The grant was limited to the first two questions presented by the petition.

SUMMARY OF ARGUMENT

A party cannot be forced to arbitrate a dispute it has not agreed to arbitrate, and accordingly arbitrability is ordinarily an issue for courts, rather than arbitrators. As this Court has held, "[u]nless the parties *clearly and unmistakably provide* otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator." *AT&T Technologies, Inc. v. Communications Workers,* 475 U.S. 643, 649 (1986) (emphasis added). This is particularly true where, as here, the issue is not whether a particular dispute falls within an acknowledged agreement of the parties to arbitrate, but instead whether there is any such agreement at all.

[11] After the court of appeals held that the arbitrators lacked jurisdiction over the Kaplans, Petitioner filed actions raising the same claims against Manuel Kaplan in the United States Bankruptcy Court for the Eastern District of Pennsylvania (Bankr. E.D. Pa. No. 94-0901) and against Carol Kaplan in the United States District Court for the Eastern District of Pennsylvania (E.D. Pa. No. 94-5941).

[12] The court of appeals did not address the "alter ego" issue on the merits, but as a proffered basis for arbitral jurisdiction over Mr. Kaplan. Pet. App. A43-A44, A52 n.29. Because it found no basis for arbitral jurisdiction over the Kaplans, the court of appeals did not reach and specifically reserved the issue of whether Mr. Kaplan had been unconditionally released from any pre-workout obligations to Petitioner. Pet. App. A30 n.16.

Petitioner cannot, and does not, deny this basic proposition. What Petitioner does, however, is propose that parties who wish to preserve the right recognized by this Court in *AT&T Technologies*—the right to an independent judicial determination of arbitrability—must undertake extraordinary procedural steps, steps that increase rather than minimize judicial intrusion into the arbitration process. According to Petitioner, such a party must immediately go to court and secure declaratory and injunctive relief blocking the arbitration, or, alternatively, must somehow otherwise prevent the arbitration from going forward and force the party seeking arbitration to go to court to obtain an order compelling it. Otherwise, according to Petitioner, an arbitrator's decision on his or her own jurisdiction bars the objecting party from *de novo* judicial consideration of the issue.

This is not, and should not be, the law. Contrary to Petitioner's suggestions, nothing in the Federal Arbitration Act ("the Act") remotely imposes such procedural requirements. Indeed, the Act fails even to provide a mechanism for seeking stays of arbitration. If seeking such a stay were intended to be a prerequisite for a party objecting to jurisdiction to obtain the independent court determination of arbitrability that is its conceded right, the drafters of the Act certainly would have addressed the question in the statute. Instead, the language and structure of the Federal Arbitration Act strongly support the proposition that courts should independently review con-

tested arbitral assertions of jurisdiction. The Act specifically provides for vacatur of arbitral awards where arbitrators "exceeded their powers," 9 U.S.C. § 10(a)(4), and nowhere indicates that courts should defer to arbitrators in applying this provision.

Given that the Federal Arbitration Act does not mandate Petitioner's approach, the question is whether this Court should impose it as a matter of policy. Contrary to Petitioner's assertion, the holding below does not pose any unfairness to the party initiating arbitration. Independent judicial review of arbitrators' jurisdictional decisions simply places the parties on an equal footing. The same approach applies to court of appeals review of questions of a district court's jurisdiction, and that has never been thought unfair to the party invoking the district court's jurisdiction. Several other courts of appeals in addition to the Third Circuit have accordingly held that where, as here, a party refuses to sign a submission agreement and unsuccessfully argues jurisdictional objections before an arbitrator, the courts should review the arbitrator's jurisdictional decision *de novo*.

The federal policies favoring enforcement of private arbitration agreements, efficient resolution of disputes, and judicial economy all support a rule that allows a party to argue jurisdictional objections to an arbitrator without waiving its rights to *de novo* judicial review of arbitrability. Under Petitioner's approach, the federal courts would necessarily become involved at the outset of *every* controversy in which there was a dispute as to arbitrability, and the objecting party desired to preserve its right to an independent judicial determination of that issue. That is because the objecting party either would have to resort to court to obtain a declaratory judgment and injunction blocking arbitration, or would have to stonewall any arbitration and force its adversary to resort to court for an order compelling arbitration. Under the approach reaffirmed by the Third Circuit, however, judicial involvement in arbitration is kept to a minimum. An

arbitrator's decision either on the jurisdictional issue or on the merits may remove the necessity for courts to consider the claims of the objecting party at all.

Neither Manuel nor Carol Kaplan signed any agreement to arbitrate any dispute with First Options. Indeed, as the court of appeals recognized, the circumstances of this case and the workout agreement from which the instant dispute arises plainly and unambiguously demonstrate the absence of an agreement to arbitrate by the Kaplans. The Kaplans did everything required under applicable law to preserve their jurisdictional objections for independent judicial review. It would be manifestly unfair to deny them such review under the circumstances of this case.

Moreover, even if this Court were to hold that the arbitrators' assertion of jurisdiction should have been reviewed with deference, the court of appeals' reversal of the arbitrators' assertion of jurisdiction over the Kaplans should be affirmed. Because the arbitrators ignored the plain, unambiguous language of the parties' agreement in forcing the Kaplans to arbitrate their dispute under the workout agreement with First Options, the arbitrators' assertion of jurisdiction over the Kaplans cannot survive even deferential review.

Finally, this Court should reject Petitioner's suggested "hybrid" or "bifurcated" standard for appellate review of district court decisions to confirm or vacate arbitral awards. Such a standard is contrary to the law of at least nine circuits, is blatantly result-oriented, and would skew the institutional relationship between the district courts and the courts of appeals.

In the instant case, the Court of Appeals for the Third Circuit properly applied ordinary appellate review, deferring to the district court's findings of fact and reviewing its legal conclusions *de novo*. Because the court of appeals reached the correct conclusion under the appropriate standard, its judgment should be affirmed.

ARGUMENT

I. THE COURT OF APPEALS CORRECTLY CONCLUDED THAT THE KAPLANS WERE ENTITLED TO INDEPENDENT JUDICIAL CONSIDERATION OF THEIR OBJECTIONS TO ARBITRAL JURISDICTION.

Petitioner concedes that whether a party has agreed to arbitrate is an issue that ordinarily merits independent judicial determination. *See* Pet. Br. at 13. However, it contends that in the instant case, the Kaplans failed to take the procedural steps necessary to obtain such a determination.

Petitioner suggests three methods by which the Kaplans could have obtained independent judicial consideration of their objections to arbitral jurisdiction. The alternative Petitioner emphasizes most heavily is that the Kaplans could have run immediately into federal court to seek declaratory and injunctive relief blocking arbitration. *See* Pet. Br. at 19, 30. Second, Petitioner suggests that the Kaplans could have refused to participate in any arbitral proceedings at all, forcing *Petitioner* to run immediately into federal court to seek an injunction compelling arbitration. *Id.*[13] The Federal Arbitration Act, this Court's prior decisions, and clearly established Third Circuit law all demonstrate, however, that such extraordinary action is not a prerequisite to preserving the right to an independent judicial determination of arbitrability. Moreover, mandating immediate resort to the

[13] This alternative was in fact not a viable one for the Kaplans, because the Exchange arbitration rules provide for the entry of awards against parties who fail to appear. R. 296. As Petitioner itself recognizes, Pet. Br. at 19, a party cannot simply refuse to participate in arbitration in such circumstances, but instead must —under Petitioner's approach—itself seek immediate judicial intervention.

courts in every instance in which a party seeks an independent judicial determination of arbitrability would frustrate the federal policies favoring enforcement of arbitration agreements, efficient resolution of disputes, and judicial economy.

A third alternative noted by Petitioner, which it relegates to a footnote, is that a party opposing arbitrability could object and refuse to allow the arbitrator to decide that question, thereby preserving it for *de novo* judicial review, while nonetheless proceeding to arbitrate the merits. *See* Pet. Br. at 19 n.2. Aside from serious practical questions regarding how a party could raise the arbitrability issue but keep the arbitrator from deciding it, this procedure is manifestly inefficient. It would require arbitrators to proceed blindly with arbitrations despite the existence of unexamined jurisdictional objections, only to have federal courts render the arbitration a nullity where those objections prove to be meritorious—as the arbitrators themselves might have concluded. Such a rule would impose unnecessary burdens on both parties and arbitrators and, not surprisingly, finds no support in the Federal Arbitration Act or this Court's prior decisions.

It is undisputed that the Kaplans never signed an arbitration provision,[14] refused to sign a submission agreement, and filed timely objections to arbitral jurisdiction. The Kaplans never agreed to give the arbitrators authority to make a binding determination of arbitrability and never agreed to forego independent judicial review. Under the Federal Arbitration Act and this Court's prior decisions, the Kaplans did everything they were required to do in order to preserve their right to *de novo* judicial review of arbitrability.

[14] Indeed, the fact that, as part of the workout, MKI and First Options signed an arbitration agreement and the Kaplans did not demonstrates a deliberate decision by the Kaplans not to arbitrate—a decision in which First Options acquiesced. *See* Pet. App. A26-A27.

A. Because The Parties Did Not Clearly And Unmistakably Provide That The Question Of Arbitrability Was For The Arbitrators And Not The Courts, The Court Of Appeals Properly Reviewed Arbitrability *De Novo*.

Petitioner concedes, as it must, that it is ordinarily "for the court, not the arbitrator, to decide in the first instance whether [a] dispute [is] to be resolved through arbitration." Pet. Br. at 13 (quoting *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. at 651). As this Court has held:

> *The question of arbitrability . . . is undeniably an issue for judicial determination.* Unless the parties *clearly and unmistakably* provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator.

Id. at 649 (emphasis added); *see also id.* at 647 (emphasis added) (" 'general rule' [is] that the issue of arbitrability is for the courts to decide unless the parties *stipulate* otherwise").

This rule "follows inexorably" from the principle that " 'arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.' " *Id.* at 648 (quoting *United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960)). Although federal courts will broadly construe the scope of an acknowledged agreement to arbitrate, no presumption of arbitrability applies to the determination of whether a party has entered into an arbitration agreement. *See McCarthy v. Azure*, 22 F.3d 351, 355 (1st Cir. 1994) ("federal policy [favoring arbitration] does not extend to situations in which the identity of the parties who have agreed to arbitrate is unclear"); *Case Int'l Co. v. T.L. James & Co.*, 907 F.2d 65, 67 (8th Cir. 1990) ("We are not inclined to find that a party has waived its right to ordinary judicial process without an express and specific agreement.").

Petitioner contends that where the parties "submit" the arbitrability issue to the arbitrator, the arbitrator's jurisdictional determination is entitled to deference. Pet. Br. at 13-32. Petitioner goes on to equate objecting to arbitrability before the arbitrator with formal "submission" of that issue to binding arbitration, but the two are quite distinct.[15]

"In the arbitration context, the 'submission,' of course, refers to the specific contract or agreement stating the precise issues to be arbitrated." *Davis v. Chevy Chase Fin. Ltd.*, 667 F.2d 160, 164 n.7 (D.C. Cir. 1981) (citing C. Updegraff, *Arbitration and Labor Relations* 125 (1970)). *Cf. Brotherhood of Painters & Allied Trades, Glaziers & Glass Workers Local No. 558 v. Lord & Burnham Constr. Corp.*, 705 F.2d 998, 999 (8th Cir. 1983) (citation omitted) ("Although the parties may specifically agree to submit questions of arbitrability to arbitration, the . . . contract's arbitration clause does not contain such an agreement."). A finding that parties have "submitted" a jurisdictional question to an arbitrator requires "clear[] and unmistakabl[e]" evidence that they agreed to do so. *See AT&T*, 475 U.S. at 647 (emphasis added) (general rule is that "arbitrability is for the courts to decide unless the parties *stipulate* otherwise").

Here, Petitioner cannot and does not contend that the parties expressly "agreed" or "stipulated" that the arbitrators could define their own jurisdiction. Instead, Petitioner contends that the Kaplans' motion to dismiss on jurisdic-

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[15] Where the parties do formally agree to submit the jurisdictional issue to the arbitrator for conclusive determination—*i.e.*, by stipulation or in a submission agreement—deferential judicial review may well be appropriate. *See Warrior & Gulf*, 363 U.S. at 583 n.7. The *Warrior & Gulf* Court cautioned, however, that in contending that such an agreement had been made, "the claimant must bear the burden of a *clear demonstration of that purpose.*" *Id.* (emphasis added). First Options cannot carry that burden here, because the Kaplans never agreed to submit *any* issue to the arbitrators.

tional grounds somehow substituted for such an express agreement. The Kaplans' vigorous denial before the arbitrators that they had agreed to arbitrate any dispute with First Options cannot fairly be turned around and cited as evidence of the requisite "clear and unmistakable" agreement.

The Kaplans refused to sign an agreement submitting *any* issue to the arbitrators. Where, as here, the party opposing arbitrability does not agree to submit the jurisdictional issue to the arbitrators for final decision, this Court's precedents require *independent* judicial review of arbitrability. *See AT&T Technologies,* 475 U.S. at 647, 649, 651; *Warrior & Gulf,* 363 U.S. at 582.

First Options' contention that the Kaplans agreed to commit the jurisdictional question to the arbitrator is belied not only by the Kaplans' conduct and the plain language of the parties' agreement, but also by common sense. Where, as in many labor disputes, the parties have an acknowledged agreement to arbitrate some controversies and the only question is whether a particular issue is arbitrable, the parties may well agree (and often do) to let the arbitrator make a binding determination of arbitrability. By contrast, where, as here, a party contends that it never agreed to arbitrate *any* dispute, that party is highly unlikely to be willing to commit the jurisdictional question to the arbitrator for final decision.

Following *AT&T Technologies,* several courts of appeals, in addition to the court below, have held that where, as here, a party refuses to sign a submission agreement and unsuccessfully argues jurisdictional objections to an arbitrator, federal courts should review the arbitrator's jurisdictional determination *de novo. See, e.g., Cargill Rice, Inc. v. Empresa Nicaraguense Dealimentos Basicos,* 25 F.3d 223 (4th Cir. 1994); *Alberici-Eby v. Local 520, Int'l Union of Operating Engineers,* 992 F.2d 727 (7th Cir. 1993). Other courts of appeals had reached the same conclusion even before this Court's decision in *AT&T Technologies. See, e.g., Davis v. Chevy Chase Fin. Ltd.,*

667 F.2d 160 (D.C. Cir. 1981); *Mobil Oil Corp. v. Local 8-766, Oil, Chem. & Atomic Workers Int'l Union,* 600 F.2d 322 (1st Cir. 1979).

Petitioner complains that *de novo* review of arbitrators' jurisdictional determinations allows the party opposing arbitration "repeated bites of the apple." Pet. Br. at 14. Exactly the same result obtains, however, where a party unsuccessfully challenges jurisdiction in federal district court. In such cases, the court of appeals reviews the jurisdictional decision independently after the district court renders its judgment on the merits. The Court of Appeals for the Third Circuit drew this analogy in *Local 719, American Bakery & Confectionery Workers v. National Biscuit Co.,* 378 F.2d 918 (3d Cir. 1967):

> In our own federal litigation system we require no special jurisdictional appearances and permit no interlocutory appeals from a court's decision in favor of its jurisdiction. Since federal labor policy with respect to arbitration favors the establishment of a private juridical system, there is even less reason to make resort to interstitial judicial activity mandatory, when the possibility exists that a labor dispute can be settled without any use of the courts whatsoever. Thus, where as here the reluctant party has presented its objection to arbitrability to the arbitrator and has not thereafter clearly indicated its willingness to forego judicial review, we believe that the issue is sufficiently preserved for our subsequent inquiry.

Id. at 921-22 (footnotes omitted). *See also Davis,* 667 F.2d at 168 ("[W]e agree with the court in *Local 719* that such a rule [limiting judicial review of an arbitrator's determination of arbitrability] might actually *foster* litigation by requiring parties disputing arbitrability to seek 'interlocutory' review of jurisdictional rulings.").

Moreover, Petitioner could have asked the federal district court to compel arbitration when the Kaplans refused to sign a submission agreement and formally ob-

jected to arbitral jurisdiction. *See* 9 U.S.C. § 4; *see also Marine Int'l Nominees v. Republic of Guinea*, 693 F.2d 1094, 1097 (D.C. Cir. 1982), *cert. denied*, 464 U.S. 815 (1983); *National R.R. Passenger Corp. v. Missouri Pac. R.R. Co.*, 501 F.2d 423, 425 (8th Cir. 1974). *Cf. Associated Brick Mason Contractors v. Harrington*, 820 F.2d 31, 38 (2d Cir. 1987) (cause of action to compel arbitration accrues when party rejects written demand for arbitration). Petitioner *chose* not to do so and, therefore, should not be heard to complain about having to litigate the jurisdictional issue more than once.

Additionally, it was First Options that *chose* to file for arbitration of its dispute with the Kaplans, even though it knew that neither Manuel nor Carol Kaplan had ever signed any document containing an arbitration provision. As the largest clearinghouse at the Exchange, First Options undoubtedly sought to gain a home-court advantage before a favorably pre-disposed Exchange Arbitration Panel. Now that the court of appeals has foiled First Options' jurisdictional gambit, First Options claims to have been treated unfairly. There is no unfairness in allowing the federal courts to prevent parties who have not agreed to arbitrate from being forced to do so.

Rather, as the Seventh Circuit has reasoned, allowing *de novo* judicial review of arbitrability determinations simply places the parties on equal footing:

> The party initiating arbitration has made a decision that the dispute is arbitrable when it initiates an arbitration proceeding. If that party felt the dispute was not arbitrable it would have chosen a forum other than arbitration. Thus, permission for the non-initiating party to preserve arbitrability objections following the arbitration hearing merely permits the non-initiating party to make the same decision concerning arbitrability that the initiating party made prior to submission of the decision to arbitrate and does not discriminate against the initiating party. Indeed, such a rule frequently is beneficial to the party who initiated arbitration in allowing that party access to the arbitral process without the necessity of the filing of a lawsuit to compel arbitration.

International Ass'n of Machinists & Aerospace Workers, Lodge No. 1777 v. Fansteel, Inc., 900 F.2d 1005, 1009 (7th Cir.), *cert. denied*, 498 U.S. 851 (1990).

B. The Language And Structure Of The Federal Arbitration Act Support *De Novo* Judicial Review Of Arbitrators' Jurisdictional Determinations.

Section 10(a)(4) of the Federal Arbitration Act provides that district courts may vacate an arbitration award "[w]here the arbitrators exceeded their powers." Courts have interpreted this provision to permit vacatur of arbitration awards where the arbitrators lacked jurisdiction. *See, e.g., Delta Queen Steamboat Co. v. District 2 Marine Eng'rs Beneficial Ass'n*, 889 F.2d 599, 602 (5th Cir. 1989), *cert. denied*, 498 U.S. 853 (1990); *Davis*, 667 F.2d at 164 n.7; *Mobil Oil Corp.*, 600 F.2d at 326; *Orion Shipping & Trading Co. v. Eastern States Petroleum Corp.*, 312 F.2d 299, 300 (2d Cir.), *cert. denied*, 373 U.S. 949 (1963). It is hard to imagine a clearer example of arbitrators exceeding their powers than where they assert jurisdiction over, and enter awards against, parties who never agreed to arbitrate.

There is no indication in section 10(a)(4), or anywhere else in the Act, that federal courts should defer to arbitrators in determining whether the arbitrators "exceeded their powers." Thus, on the face of the Act, the inquiry under section 10(a)(4) should be *de novo*.

Petitioner argues that the Federal Arbitration Act "provides a clear mechanism for a party that objects to arbitration on jurisdictional grounds to obtain a judicial ruling on arbitrability in the first instance." Pet. Br. at 18. The Act does nothing of the sort; it provides *no means* for an objecting party to do what Petitioner says it must do—secure a stay of arbitration and resort to court for

a judicial ruling on arbitral jurisdiction. *See Tai Ping Ins. Co. v. M/V Warschau*, 731 F.2d 1141, 1144 (5th Cir. 1984) ("There is no provision in the Act for a stay of arbitration."). *Cf. Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 476 (1989) (Act contains no provision authorizing stay of arbitration pending resolution of related litigation).[16] The only stay provision in the Act authorizes parties *desiring* arbitration to seek a stay of *judicial* proceedings. *See* 9 U.S.C. § 3. Indeed, Petitioner is reduced to Orwellian doublespeak in arguing that the procedural mechanism provided by the Act for parties objecting to arbitration is "the opportunity to defend against a section 3 or section 4 application." Pet. Br. at 19. The "opportunity" to be a defendant is a curious procedural protection;[17] the failure of the Act to provide a means for an objecting party to obtain a prior judicial ruling on arbitrability strongly suggests that Congress did not view such a *prior* ruling as a prerequisite to preserving the party's conceded right to a *de novo* judicial determination.

On the face of the Act, the *only* ways to remedy arbitrators' jurisdictional excesses are: (1) a petition to vacate the award under section 10(a)(4); or (2) a petition to modify or correct an award under section 11(b). *See Davis*, 667 F.2d at 164 n.7 ("power to review arbitration awards made with regard to nonarbitral matters derives from both" § 10(a)(4) and § 11(b)). Because "the issue of arbitrability is for the courts to decide," *AT&T Technologies*, 475 U.S. at 647, review of arbitrability under these sections should be *de novo*.

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[16] Declaratory judgments and injunctions blocking arbitration are general judicial remedies for unjustified arbitral assertions of jurisdiction; such remedies are not provided by the Act. *Tai Ping Ins. Co.*, 731 F.2d at 1144.

[17] This "opportunity" is not even present where, as here, the pertinent arbitration rules contain a default provision. *See* note 13, *supra*.

C. The Federal Policies Favoring Enforcement Of Private Arbitration Agreements, Efficient Resolution Of Disputes, And Judicial Economy All Support Allowing A Defendant To Argue Jurisdictional Objections To An Arbitrator Without Waiving Its Right To *De Novo* Judicial Review Of Arbitrability.

The principal purpose of the Federal Arbitration Act is "to ensure judicial enforcement of privately made agreements to arbitrate." *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219 (1985). *See Allied-Bruce Terminix Cos., Inc. v. Dobson*, No. 93-1001 (Jan. 18, 1995). No federal policy favors arbitration where, as here, the parties have not agreed to arbitrate. *See Volt*, 489 U.S. at 478; *AT&T Technologies*, 475 U.S. at 648. "[T]he federal policy is simply to ensure the enforceability, according to their terms, of private *agreements* to arbitrate." *Volt*, 489 U.S. at 476 (emphasis added).

Indeed, requiring courts to defer to arbitrators' jurisdictional decisions would deter parties from entering into arbitration agreements. As this Court has noted, "[t]he willingness of parties to enter into agreements that provide for arbitration of specified disputes would be 'drastically reduced' . . . if [an] arbitrator had the 'power to determine his own jurisdiction. . . .'" *AT&T Technologies*, 475 U.S. at 651 (quoting Cox, *Reflections Upon Labor Arbitration*, 72 Harv. L. Rev. 1482, 1509 (1959)). Therefore, to the extent the courts have an interest in encouraging arbitration agreements, that interest would be furthered by a rule allowing meaningful judicial review of arbitrators' jurisdictional rulings.

Requiring parties to seek a stay of arbitration in order to obtain an independent judicial determination of arbitrability would also frustrate a second purpose of the Act: the efficient and speedy resolution of disputes. *See Byrd*, 470 U.S. at 220-21. Petitioner's rule would force arbitral defendants to interrupt the arbitral process at the outset whenever they possessed a jurisdictional objection. Such a manifestly inefficient result should be avoided. *See Jones Dairy Farm v. Local No. P-1236, United Food & Commercial Workers Int'l Union*, 760 F.2d 173, 175

(7th Cir.) (Posner, J.) ("It is desirable to put as much of the case as possible to the arbitrator, and not encourage parties to go to court before the arbitration can begin"), *cert. denied*, 474 U.S. 845 (1985).[18] As the court below explained, "[f]ederal courts encourage participation in arbitration. Requiring parties to refuse to participate in order to challenge arbitral jurisdiction would not advance this goal." Pet. App. A17.

A rule allowing an arbitration to proceed while jurisdictional objections are preserved for *de novo* judicial review makes it possible for the entire controversy to be resolved by the arbitral process, with its concomitant speed and efficiency. As Professor Siegel observed:

> It may well happen, of course, that the person opposing the arbitration has won it on the merits, either in full or at least in sufficient measure to accept the award, and that the victory will induce the abandonment of the objection to the arbitral forum. (Winning the battle always helps the winner forget who chose the battlefield.)

David D. Siegel, *Appeals from Arbitrability Determinations Under the New § 15 of the U.S. Arbitration Act*, 126 F.R.D. 589, 594 (1989).[19]

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[18] Petitioner cites *Jones Dairy Farm* for the proposition that when a party presents the arbitrability question to the arbitrator, courts will not "second-guess" the arbitrator's decision on that issue. *See* Pet. Br. at 29 n.4. The case, however, does not support that proposition. Indeed, the rule in the Seventh Circuit is to the contrary. *See Alberici-Eby*, 992 F.2d at 732; *Edward D. Jones & Co. v. Sorrells*, 957 F.2d 509, 514 (7th Cir. 1992); *Fansteel*, 900 F.2d at 1009-10.

In *Jones Dairy Farm*, the parties "never questioned the arbitrator's authority" until after the award had been entered. 760 F.2d at 175. The court of appeals therefore held that "by submitting without a peep to the arbitrator's jurisdiction," Jones Dairy Farm waived its right to contest arbitrability in court. *Id.* at 176. The Kaplans, by contrast, vigorously contested the arbitrator's jurisdiction from the outset.

[19] Petitioner itself asserts that the approach of the Third Circuit "encourages a party to present its case on arbitrability and on the merits to the arbitrator" (Pet. Br. at 25)—serving the very policy Petitioner discerns in the Federal Arbitration Act. Petitioner goes on to note that the objecting party in presenting its case will be "secure in the knowledge that if it loses it can reopen the arbitrability issue for *de novo* review by the court," *id.*, but that is equally true, for example, of similar jurisdictional rulings by district courts, and is simply a function of the fact emphasized by this Court in *AT&T*—that arbitrability is for courts, not arbitrators, to decide.

Petitioner's rule would be particularly inefficient where, as here, some arbitral defendants object to jurisdiction and some do not. If the arbitration were allowed to proceed as to the non-objecting defendants while the court considered the jurisdictional issue, duplicative arbitral proceedings involving the objecting defendants would ensue if the court rejected the jurisdictional objections. If, on the other hand, the arbitration were stayed as to all parties pending resolution of the jurisdictional objections, the parties without jurisdictional objections would be delayed unnecessarily from resolving their disputes.

In the instant case, by contrast, the arbitration was allowed to proceed as to all parties, and the court addressed the jurisdictional objections at the conclusion of the arbitration. No matter how the court ruled on the jurisdictional objections, no further arbitral proceedings would have been required.

Finally, considerations of judicial economy weigh heavily against adopting Petitioner's proposed rule.[20] Requiring objecting arbitrants to seek immediate declaratory and injunctive relief in order to obtain an independent judicial

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[20] We agree with Petitioner that one of the beneficial results of arbitration agreements is that they reduce the workload of the federal courts. *See* Pet. Br. at 25-26. The reduction in court dockets that Petitioner argues would accompany adoption of its proposal is based solely on the different standard of review it would have a court apply. While it may well be that a more deferential standard would discourage some objecting parties from pursuing the jurisdictional issue in the courts, any such reduction would be more than outweighed by the additional court actions at the outset of arbitration that Petitioner's approach would require.

ruling on arbitrability would force the federal courts to become involved every time a jurisdictional objection were raised, resulting in additional burdens on crowded court dockets and additional expense to the parties. Moreover, such a rule would require the federal courts to address disputes prematurely, rather than waiting to see whether the disputes could be resolved satisfactorily without court involvement. Conversely, the rule applied by the court of appeals in this case allows the arbitration process an opportunity to obviate the need for court involvement. *See Fansteel*, 900 F.2d at 1009 ("In permitting an arbitrator to attempt to address a dispute prior to a judicial arbitrability determination, parties may well be able to resolve their disputes without requiring the involvement of the judiciary.").

As the D.C. Circuit has reasoned:

> Although we are aware of decisions suggesting that review of an arbitrator's determinations of arbitrability should be limited, *see, e.g., Yakima Newspaper Guild, Local 27 v. Republic Publishing Co.*, 375 F. Supp. 945, 947 (E.D. Wash. 1974), we agree with the court in *Local 719* that such a rule might actually *foster* litigation by requiring parties disputing arbitrability to seek "interlocutory" review of jurisdictional rulings. [*Davis*, 667 F.2d at 168 (citing *Local 719*, 378 F.2d at 921).]

Petitioner suggests in a footnote that a party may be able to obtain an independent judicial decision on arbitrability " 'by simply not giving the arbitrability question to the arbitrator for decision,' but instead expressly 'reserving that question for later judicial determination.' " Pet. Br. at 19 n.2 (quoting *George Day Constr. Co. v. United Bhd. of Carpenters & Joiners, Local 354*, 722 F.2d 1471, 1476 (9th Cir. 1984)). Petitioner completely fails to explain how, as a practical matter, a party could keep an arbitrator who wished to address jurisdictional objections from doing so.

Moreover, under this procedure, arbitrators would be required to proceed to the merits of an arbitration, despite the possibility that they themselves might conclude, after hearing the parties' arguments, that they lack jurisdiction. Such a process is obviously inefficient and would engender a massive waste of time and resources by parties and arbitrators alike. It makes far more sense to allow arbitrators, aided by the parties' arguments, the chance to act as their own gatekeepers in the first instance.

There is, of course, some cost in not insisting—as Petitioner would—that the *de novo* judicial determination of arbitrability take place in every instance before arbitration. If a reviewing court determines that the arbitrator lacked jurisdiction, the time spent before the arbitrator will in a sense have been wasted. But that loss is plainly outweighed by the clear gains in reduced judicial involvement (because the arbitrator's decision may render resort to the courts unnecessary or may dissuade the objecting party from the desirability of such resort) and by the increased respect for the arbitral process (because courts are not required to intrude at the outset of the process in every case of a jurisdictional objection and parties are not required to stonewall an arbitrator to protect their right to *de novo* judicial review of arbitrability). This cost/benefit analysis should seem familiar; it tracks the similar calculus underlying the final judgment rule. In applying that rule, this Court has recognized that any losses caused by generally requiring district courts to decide the merits before a reviewing court can address a jurisdictional objection are outweighed by gains in judicial economy and efficiency and institutional respect for the district courts. *See, e.g., Digital Equip. Corp. v. Desktop Direct, Inc.*, 114 S. Ct. 1992 (1994); *Richardson-Merrell, Inc. v. Koller*, 472 U.S. 424, 430 (1985); *Firestone Tire & Rubber Co. v. Risjord*, 449 U.S. 368, 374 (1981).

D. It Would Be Fundamentally Unfair To Deny Respondents *De Novo* Judicial Review Of Arbitrability Under The Circumstances Of This Case.

Neither Manuel nor Carol Kaplan signed any agreement to arbitrate any dispute with First Options. As the court of appeals held:

> These [workout] documents limited the Kaplans' obligations to the contribution of certain fixed sums and contained no promise to arbitrate. Thus, though we will separately consider all three of First Options' variations on the theme of consent, the common denominator which applies to all is the absence of any agreement to arbitrate in the only workout document the Kaplans signed as individuals. [Pet. App. A24.]

Despite the absence of any agreement to arbitrate their dispute with First Options, the Kaplans were hauled into arbitration before the Exchange, in which First Options was the largest clearinghouse. J.A. 65. Faced with the prospect of litigating sizable claims in a hostile arbitral forum they never agreed to, the Kaplans refused to sign a submission agreement and filed formal objections to Exchange jurisdiction. Pet. App. A18; J.A. 54-55. After some limited discovery had taken place, the Kaplans reiterated their jurisdictional objections in a formal motion to dismiss, which the arbitrators summarily denied. J.A. 55.

After thus putting the arbitrators and First Options on notice of their substantial (and meritorious) jurisdictional objections, the Kaplans participated in the arbitration hearing. Never during the course of the arbitration did the Kaplans "indicate[] [a] willingness to forego judicial review" of their jurisdictional objections.[21]

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[21] Under Third Circuit law, arbitrability objections are fully preserved unless a party "'clearly indicate[s] his willingness to forego judicial review.'" *Pennsylvania Power Co. v. Local Union No. 272*, 886 F.2d 46, 50 (3d Cir. 1989) (quoting *Local 719, American Bakery & Confectionery Workers v. National Biscuit Co.*, 378 F.2d 918, 921-22 (3d Cir. 1967)).

On appeal of the arbitrators' award in favor of First Options, the court of appeals correctly found that, as the Kaplans had maintained from the outset, the arbitrators lacked jurisdiction over the Kaplans. Pet. App. A3-A4. Now, First Options contends that because the Kaplans did not seek to enjoin the arbitration proceedings, the court of appeals should have deferred to the arbitrators' assertion of jurisdiction.

Under settled Third Circuit law, the Kaplans were not required to seek a stay of arbitration in order to preserve their jurisdictional objections for *de novo* judicial review. *See Pennsylvania Power Co. v. Local Union No. 272*, 886 F.2d 46, 50 (3d Cir. 1989); *International Bhd. of Teamsters, Chauffeurs, Warehousemen and Helpers, Local 249 v. Western Pa. Motor Carriers Ass'n*, 574 F.2d 783, 787 (3d Cir.), *cert. denied*, 439 U.S. 828 (1978); *Local 719*, 378 F.2d at 921-22. *See also AT&T Technologies*, 475 U.S. at 649 (emphasis added) ("Unless the parties *clearly and unmistakably* provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator.").[22]

The Kaplans did everything required under applicable law to preserve their meritorious jurisdictional objections for *de novo* judicial review.[23] It would be fundamentally unfair to devise a new, judge-made rule and apply it to the Kaplans, potentially saddling them with an enormous judgment unsupported by the facts, *see* Pet. App. A52, entered by a tribunal that lacked jurisdiction. Pet. App. A3-A4.

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[22] Nor were the Kaplans required to forego litigation of Mr. Kaplan's counterclaim. *See* Pet. App. A21 (citing cases).

[23] The fact that the Kaplans did everything required by Third Circuit law to preserve their jurisdictional objections for *de novo* judicial review provides additional evidence that they never intended to submit the jurisdictional issue to the arbitrators for final decision.

E. Even If The Courts Were To Review The Arbitrators' Assertion Of Jurisdiction With Deference, The Award Against The Kaplans Could Not Stand.

As noted above, the Kaplans never signed any document containing an arbitration agreement. Pet. App. A24. Only one of the four contracts comprising the workout from which the instant dispute arises contained an arbitration provision, and that contract was signed only by First Options and MKI. J.A. 30-36, 57. Manuel and Carol Kaplan individually signed only one of the four contracts (the Letter Agreement), and that contract did not contain an arbitration clause. J.A. 4-23.

As the court of appeals held:

> The circumstances of this case *plainly negate* the Kaplans' consent to arbitrate their individual responsibility for MKI's obligations. . . . There is *no ambiguity* about the absence of any consent to arbitrate in the documents the Kaplans signed individually. [Pet. App. A26-A27 (emphases added).]

Even under the deferential review accorded an arbitrator's decision on the merits (as opposed to the contested arbitrability) of a controversy, an award must be vacated when it is in manifest disregard of the parties' agreement. *Exxon Shipping Co. v. Exxon Seamen's Union*, 993 F.2d 357, 360 (3d Cir. 1993). "[A]n arbitrator is confined to interpretation and application of the . . . agreement; he does not sit to dispense his own brand of industrial justice." *United Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 596 (1960).[24]

Thus, an arbitral award should be vacated "where an arbitrator 'manifest[s] an infidelity' to her obligation to interpret the contract, [or] ignores a plain and unam-

[24] *See also St. Louis Theatrical Co. v. St. Louis Theatrical Bhd. Local 6*, 715 F.2d 405, 407-09 (8th Cir. 1983) (arbitrator is not free to impose his own sense of fairness); *Totem Marine Tug & Barge, Inc. v. North Am. Towing, Inc.*, 607 F.2d 649, 651 (5th Cir. 1979).

biguous provision of the contract." *Apex Fountain Sales, Inc. v. Kleinfeld*, 818 F.2d 1089, 1094 (3d Cir. 1987) (citations omitted); *see also id.* at 1096 n.5 (citing cases); *Inter-City Gas Corp. v. Boise Cascade Corp.*, 845 F.2d 184, 187 (8th Cir. 1988) ("Although the arbitrator may interpret ambiguous language, the arbitrator may not disregard or modify unambiguous contract provisions."). Where the language of a contract is clear and unambiguous, an arbitrator is bound to enforce that language, which represents the bargain of the parties. Failure to do so mandates vacatur.

> "The arbitrator may not ignore the plain language of the contract. . . ." If the language of an agreement is clear and unequivocal, an arbitrator cannot give it a meaning other than that expressed by the agreement.

Georgia-Pacific Corp. v. Local 27, United Paperworkers Int'l Union, 864 F.2d 940, 944 (1st Cir. 1988) (quoting *United Paperworkers Int'l Union v. Misco, Inc.*, 484 U.S. 29, 38 (1987)); *accord, AP Parts Co. v. UAW*, 923 F.2d 488, 491-92 (6th Cir. 1991) (award vacated where "arbitrator ignored the plain language of the contract and rendered an award outside the purview of his authority"); *Leed Architectural Prods., Inc. v. United Steelworkers, Local 6674*, 916 F.2d 63, 65 (2d Cir. 1990); *Tootsie Roll Indus., Inc. v. Local Union No. 1, Bakery, Confectionery & Tobacco Workers Int'l Union*, 832 F.2d 81, 84 (7th Cir. 1987).

Here, as the court of appeals determined, there was "no ambiguity" about the lack of any consent by the Kaplans to arbitrate. Pet. App. A27. Therefore, even under a deferential standard of review,[25] the arbitrators' assertion of jurisdiction over the Kaplans cannot stand.

[25] It is not at all clear what Petitioner means by a "deferential" review as to arbitral jurisdiction, but whatever standard is applied, here there was no agreement to arbitrate and no jurisdiction. No amount of deference can create an agreement where it does not

II. THE COURT OF APPEALS PROPERLY REVIEWED THE DISTRICT COURT'S DENIAL OF VACATUR UNDER ORDINARY STANDARDS OF APPELLATE REVIEW.

The court of appeals, in conformity with the well-established law of the Third Circuit and at least eight other circuits,[26] reviewed the district court's denial of the motion to vacate "*de novo*." In the court of appeals' words:

> We will exercise plenary review over the district court's determination that the arbitration panel had jurisdiction over the Kaplans insofar as it turns on questions of law. To the extent that the district court's determination of arbitral jurisdiction turns on findings of fact, however, our scope of review will be limited to whether those findings are clearly erroneous. [Pet. App. A15 (citation omitted).]

This was not only consistent with the law of nine circuits, it was an exercise of what Petitioner itself describes as "ordinary standards of appellate review." Pet. Br. at 36. Petitioner, however, asks this Court to adopt the more deferential "abuse of discretion" standard for appeals from district court decisions confirming or refusing to vacate arbitration awards, while retaining the ordinary, more exacting standard of review where district courts vacate or refuse to confirm arbitration awards.

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exist, and no amount of deference can confer jurisdiction on an arbitral panel that does not otherwise possess it.

[26] *See Advest, Inc. v. McCarthy*, 914 F.2d 6, 8 (1st Cir. 1990); *In re Arbitration No. AAA 13-161-0511-85*, 867 F.2d 130, 131 (2d Cir. 1989); *Amerada Hess Corp. v. SS Athena*, 1987 WL 37022, at *1 (4th Cir. Apr. 9, 1987) (unpublished decision), *cert. denied*, 484 U.S. 848 (1987); *McIlroy v. PaineWebber, Inc.*, 989 F.2d 817, 819-20 (5th Cir. 1993); *Moseley, Hallgarten, Estabrook & Weeden v. Ellis*, 849 F.2d 264, 267 (7th Cir. 1988); *Pack Concrete, Inc. v. Cunningham*, 866 F.2d 283, 284 (9th Cir. 1989); *Bowles Fin. Group, Inc. v. Stifel, Nicolaus & Co.*, 22 F.3d 1010, 1012 (10th Cir. 1994); *Parmac, Inc. v. I.A.M. Nat'l Pension Fund Benefit Plan A*, 872 F.2d 1069, 1071 (D.C. Cir. 1989).

Petitioner argues that this rule, recently pronounced by the Eleventh Circuit, should be adopted because it "properly reflects federal arbitration policy." Pet. Br. at 34. Appellate standards of review, however, are functions of the respective capabilities and institutional needs of trial and appellate courts,[27] not means of promoting substantive policies by having courts of appeals place a thumb on the scales in favor of certain substantive outcomes.[28] Accordingly, this Court should reject the so-called "hybrid" or "bifurcated" standard of review, which would divert the courts of appeals from their traditional role of correcting error and promoting doctrinal uniformity,[29] and relegate them to the role of result-driven rubber stamps. The judgment of the court of appeals should be affirmed as a proper exercise of ordinary appellate review.

A. The Standard Of Appellate Review Should Not Depend On The Outcome In The Court Below.

Appellate standards of review are determined by the respective capabilities and duties of trial and appellate

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[27] *See Salve Regina College v. Russell*, 499 U.S. 225, 231, 233 (1991) ("As a general matter, of course, the courts of appeals are vested with plenary appellate authority over final decisions of district courts. . . . Those circumstances in which Congress or this Court has articulated a standard of deference for appellate review of district court determinations reflect an accommodation of the respective institutional advantages of trial and appellate courts.").

[28] *Cf. State Establishment for Agric. Prod. Trading v. M/V Wesermunde*, 770 F.2d 987, 991 n.5 (11th Cir. 1985) ("The policy favoring arbitration does not and may not control the determination of appellate jurisdiction.").

[29] *See Church of Scientology v. IRS*, 792 F.2d 153, 155 n.1 (D.C. Cir. 1986) ("appellate review serves a dual purpose: the correction of legal error and the establishment of legal rules for future guidance"), *aff'd*, 484 U.S. 9 (1987); A.B.A. Commission on Standards of Judicial Administration, Standards Relating to Appellate Courts (1977) 3.00 commentary ("The appellate courts have two functions: to review individual cases to assure that substantial justice had been rendered, and in connection therewith to develop the law for general application in the legal system.").

courts. Appellate courts, which have the power to bind courts throughout their jurisdiction as well as the advantages of time for unhurried deliberation, "reflective dialogue and collective judgment," *Salve Regina College*, 499 U.S. at 232, have primacy on matters of law and exercise plenary review of legal conclusions. Trial courts, on the other hand, have more experience as factfinders and are closer to the evidence, and accordingly their findings of fact may be reversed only if clearly erroneous. *See Anderson v. City of Bessemer*, 470 U.S. 564, 574 (1985) ("The trial judge's major role is the determination of fact, and with experience in fulfilling that role comes expertise."). Day-to-day docket, discovery, and trial management responsibilities require the balancing of numerous interrelated concerns, and accordingly rulings in this area are reviewed only for abuse of discretion. *Salve Regina College*, 499 U.S. at 233 (it is especially common for issues "involving supervision of litigation to be reviewed for abuse of discretion").[30]

By subjecting only "anti-arbitration" decisions to ordinary appellate review, Petitioner would have this Court alter the established division of responsibility by making the standard of appellate review turn not on the nature of the issue presented on appeal, but instead on the way the district court decided the issue. Such a one-sided approach would permit legal errors to go uncorrected and skew the orderly development of the law.

Petitioner cites no other area of law in which courts of appeals apply such a "bifurcated" standard, depending on the outcome below. Nor does Petitioner cite any other area of law in which courts of appeals defer to a district

[30] *See also Founding Church of Scientology v. Webster*, 802 F.2d 1448, 1457 (D.C. Cir. 1986) ("The abuse of discretion standard calls on the appellate department, in a spirit of humility occasioned by not having participated in what has gone before, not just to scrutinize the conclusion but to examine with care and respect the process that led up to it."), *cert. denied*, 484 U.S. 871 (1987).

court's review of another entity's decision. Indeed, in other areas in which district courts review decisions of other entities, the courts of appeals apply ordinary principles of appellate review. *See, e.g., Novicki v. Cook*, 946 F.2d 938, 941 (D.C. Cir. 1991) ("We do not defer to a district court's review of an agency adjudication any more than the Supreme Court defers to a court of appeals' review of such a decision"); *In re G.S.F. Corp.*, 938 F.2d 1467, 1474 (1st Cir. 1991) ("the circuit courts that have considered the issue have uniformly held that in appeals from the decision of a district court on appeal from the bankruptcy court, the court of appeals independently reviews the bankruptcy court's decision"); *United States v. Lamon*, 930 F.2d 1183, 1187 (7th Cir. 1991) ("we review *de novo* the determination by the district court that the magistrate had a substantial basis for finding probable cause"); *Malarkey v. Texaco, Inc.*, 983 F.2d 1204, 1212-13 (2d Cir. 1993) (court of appeals reviews *de novo* district court's decision whether to overturn jury verdict). *See also Salve Regina College*, 499 U.S. at 231 (court of appeals reviews district court determination of state law *de novo*).[31]

Petitioner does not argue that district courts are better able to review arbitration awards under the applicable legal criteria, or that the smooth functioning of district courts requires that their confirmation of arbitral awards be given special deference. Rather, it argues that the "hybrid" rule would promote the "primary advantages of arbitration—speed and finality." Pet. Br. at 34. This argument proves too much. There is no reason to assume that courts of appeals will rule on cases under the abuse-of-discretion standard significantly more quickly than under the *de novo* standard. The standard of review is, at most, a minor factor in determining the amount of

[31] In these situations, too, appellants get more than one "bite at the apple," but this has not provoked an alteration of ordinary standards of appellate review.

time it takes to dispose of an appeal.[32] Indeed, given the highly subjective element inherent in abuse-of-discretion review, any gain in finality would be more than offset by the loss of predictability and consistency of outcome. *See* 1 S. Childress & M. Davis, *Standards of Review* 232 (1986) ("[T]he concept of discretion quite naturally fights uniformity, so it should not be surprising that review of discretion is not consistently applied or even theorized.").

Petitioner's contention that the "hybrid" rule "derives considerable support from the structure of the Arbitration Act," Pet. Br. at 34, is also without merit. Petitioner relies on Section 16 of the Act, which specifically permits appeals from orders which refuse to stay litigation in favor of arbitration, or which refuse to compel arbitration, 9 U.S.C. § 16(a)(1), while not permitting appeals of "interlocutory" orders which do stay litigation, refuse to enjoin arbitration, or compel arbitration, 9 U.S.C. § 16(b). Petitioner's argument fails, however, to account for the fact that Section 16 also permits appeals from "final" orders compelling arbitration. 9 U.S.C. § 16 (a)(3); *Stedor Enterprises, Ltd. v. Armtex, Inc.*, 947 F.2d 727, 730-31 (4th Cir. 1991); Siegel, *supra*, 126 F.2d at 590. More importantly, Section 16 was not intended to skew the appellate process in favor of arbitration, but rather to clarify the application of the final judgment rule in the context of arbitration-related district court proceedings.[33] It addresses the *timing* of appellate review, not the standard of review.

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[32] Petitioner does not address what would occur in the not uncommon situations where district courts vacate arbitration awards only in part, or where they modify awards and confirm them as modified. Presumably, courts of appeals will then have to apply both prongs of the "bifurcated" standard of review in a single appeal, resulting in no additional speed or finality, but only additional confusion.

[33] *See* 134 Cong. Rec. S16,309 (Oct. 14, 1988):

> [U]nder the proposed statute, appealability does not turn solely on the policy favoring arbitration. Appeal can be taken from final judgments, including a final judgment in an action to compel arbitration, a final judgment that refuses to enjoin arbitration, or a final judgment dismissing an action in deference to arbitration. These appeals preserve the general policy that appeal should be available where there is nothing left to be done in the district court.

B. The Court Of Appeals Exercised "Ordinary" Appellate Review.

Petitioner, in the alternative, urges this Court to reverse the court of appeals on grounds not raised in its petition for certiorari, namely that the court of appeals failed to apply "ordinary" standards of appellate review. Pet. Br. at 36-39. Because this issue is raised for the first time in Petitioner's Brief, it should not be considered. Sup. Ct. R. 24.1(a); *Taylor v. Freeland & Kronz*, 112 S.Ct. 1644, 1649 (1992). Even if the Court chooses to reach this issue, Petitioner's contention should be rejected.

Petitioner argues that the district court's conclusion that the arbitrators had jurisdiction was "fact-bound" and should have been "upheld under the clearly erroneous standard." Pet. Br. at 37. Notably, however, the district court did not view its task as involving the resolution of disputed issues of fact. To the contrary, the district court found that "the parties have stipulated to virtually all of the pertinent facts." Pet. App. C2.[34] The jurisdictional issues before the district court were issues of law "ordinarily" subject to plenary appellate review, especially where, as here, the underlying facts were undisputed.[35]

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[34] Indeed, Petitioner concedes that the "court of appeals did not dispute the facts underlying the district court's decision (many of which had been stipulated by the parties)." Pet. Br. at 31-32.

[35] *See, e.g., Bradford-White Corp. v. Ernst & Whinney*, 872 F.2d 1153, 1160 (3d Cir.), *cert. denied*, 493 U.S. 993 (1989); *R.M. Perez & Assocs. v. Welch*, 960 F.2d 534, 537 (5th Cir. 1992); *FSC Sec. Corp. v. Freel*, 14 F.3d 1310, 1311-12 (8th Cir. 1994); *Morris v. Commodity Futures Trading Comm'n*, 980 F.2d 1289, 1294 (9th Cir. 1992); *First Investors Corp. v. American Capital*

Finally, the court of appeals made it clear that "[t]o the extent that the district court's determination of arbitral jurisdiction turns on findings of fact . . . our scope of review will be limited to whether those findings are clearly erroneous." Pet. App. A15.

Thus, Petitioner's belatedly raised final argument is based on a misunderstanding of what both the district court and the court of appeals did in this case. It is clear from the record that the court of appeals properly exercised ordinary appellate review.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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Fin. Servs., 823 F.2d 307, 309 (9th Cir. 1987); *Larson v. Tansy*, 911 F.2d 392, 394 (10th Cir. 1990).